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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1945.

No. 1171

BIRCH RANCH AND OIL COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

Summary Statement of the Matter Involved.

Under the provisions of paragraph (c) (4) of Section 23, and of Sections 41 and 43, of the Revenue Acts of 1936 and 1938, petitioner claimed a deduction of $120,000 on its income tax return for the years 1937 and 1939, accrued on its books to meet taxes of California Reclamation District No. 2035. The commissioner disallowed the deduction, with the exception of a small amount paid by

taxpayer in cash, based upon conclusions: That petitioner's system of accounting as to its Conaway ranch operations is upon a cash basis; that such payments constitute not taxes but interest not deductible unless paid within two and one-half months after the close of the taxable year; and that "the form employed in creating the alleged liability is unreal and a sham," including the validity and reality of said bonds, said reclamation district, and petitioner's existence as a separate corporate entity. [R. 40.]

Petitioner sought a redetermination in the Tax Court of the right to deduct the whole of said $120,000 on the grounds that: Its system of accounting as to all of its operations, including the Conaway ranch, is on an accrual basis in accordance with the provisions of section 43 of said revenue acts; that said item represents not interest but taxes; and that each of the commissioner's other findings are also erroneous. [Assignments of Error, 4a to 4bb, R. 50 to 12.]

The Tax Court disallowed the deduction, with the exception of an additional small amount allowed upon the theory that such additional amount was also a payment of interest made in cash within said required period. With reference to petitioner's system of accounting, it would seem that it made findings of primary facts establishing that every item of account which could properly be entered as an accrued item was so entered. It reported on an accrual basis the only accrued item which concerned the ranch. It found:

> "All crops grown on the ranch during a given fiscal year are sold in the same year in which grown. The herd of sheep is kept at an average of 3,500, with losses being replaced by younger animals. All sales are made for cash, as are all purchases. The peti-

tioner keeps a separate set of books with respect to the ranch operations." * * * [R. 97.]

"The petitioner in its income tax returns for the fiscal years 1937 and 1939 claimed for each year a deduction of $120,000, *representing the amount accrued on its books* to cover interest on the bonds of Reclamation District No. 2035." * * * [R. 98.]

"In addition to the ranch and the interest in the Birch Oil Company, the petitioner owns a citrus grove and various rental properties, including two small farms. The income from the expenses incident to those properties *are entered on petitioner's books as they accrue.*" (Emphasis added.) [R. 98.]

Notwithstanding the aforesaid findings of primary facts, the Tax Court concluded that petitioner's "ranch books are kept on a cash basis" [R. 97.] and that such portion of the aforesaid deductions as is allowable at all is allowable not as taxes but as interest, thereby, petitioner contends, raising two "clear-cut mistakes of law." The Tax Court also made findings of primary facts in substantial detail favorable to taxpayer upon each of the other aforesaid issues. [R. 83 to 100.] It failed, however, to make any ultimate finding or conclusion upon any of such other issues. [R. 101 to 108.]

Petitioner sought review in the Circuit Court of Appeals upon the ground not only of such asserted clear-cut mistakes of law but upon the further ground that a taxpayer is entitled in a tax case to ultimate findings upon all issues raised.

Jurisdiction.

The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. 347). Judgment was entered in this case by the United States Circuit Court of Appeals on January 7, 1946. [R. 241.] A petition for rehearing was filed February 6, 1946, and an order denying said petition was made and filed February 13, 1946. [R. 242.]

Questions Presented.

1. Whether a clean-cut mistake of law is presented where the Tax Court found that petitioner entered on its books of account every item of accounts receivable and payable as the same accrued and concluded nevertheless that its books of account are kept on a cash basis.

2. Whether a payment by a land owner in a California reclamation district to the county treasurer in cash, or with interest coupons of reclamation bonds of such district, is deductible in its income tax return as taxes, and not as interest.

3. Where assertedly erroneous findings of the Commissioner of Internal Revenue in assessing a deficiency income tax seriously affect the market value of a taxpayer's assets, its status as a separate corporate entity, and leave uncertain the character of its system of accounting and its future tax liability, and where taxpayer expressly seeks a redetermination of, and the Tax Court finds primary facts favorable to the taxpayer upon, each of such issues, whether taxpayer is entitled to ultimate findings and conclusions thereon, particularly in view of the fact that declaratory, or any other form of, relief is not available in tax matters.

Reasons for Granting the Writ.

1. The Tax Court made primary findings of fact establishing that petitioner entered on its books of account every item of accounts receivable and payable as the same accrued, including the only accrued item which concerned the ranch. [R. 98.] It did not find that this system did not correctly reflect petitioner's net income. It nevertheless concluded that its ranch books are kept on a cash basis. The circuit court held this conclusion to be a question of fact behind which it cannot go, citing *Dobson v. Commissioner of Internal Revenue,* 320 U. S. 489, 88 L. Ed. 249, and *United States v. Anderson,* 269 U. S. 422, 443, 70 L. Ed. 347, 352, in support of its decision. It would seem that on the contrary this holding is in conflict with both decisions and has no "reasonable basis in the law." In the *Anderson* case this court held that findings of fact, such as those involved herein, affirmatively establish that the books of account are kept on an accrual basis. In the *Dobson* case this court held that though a court may not review a decision of the Tax Court, except upon a clear-cut mistake of law, the Tax Court's decision, however, "must have 'warrant in the record' and a reasonable basis in the law."

2. Petitioner presented the question as to whether it kept its books on the accrual basis under the provisions of Section 43 of the Revenue Act of 1936. The primary findings "misconstrued the extent of the power conferred by the revenue act." In holding that there is no clear-cut mistake of law presented, the circuit court therefore held also in conflict with the holding of this court in *Security F. M. Co. v. Commissioner of Internal Revenue,* 321 U. S. 281, 286, 88 L. Ed. 725, 729, which compared the *Dobson* case, and held that under facts similar to the in-

stant case the question is not whether the Tax Court made a determination of fact but that it is rather whether, as a matter of law, the Tax Court "misconstrued the extent of the power conferred by the revenue act."

3. It would seem that a granting of the writ would be particularly apt at this time in the interest of good administrative tax law. In the *Dobson* case this court summarized the right of review in tax matters and limited it to a clear-cut question of law. In the *Security F. M. Co.* case, thereafter decided, a majority of this court held as above stated but a minority of this court held that the case should be governed by *Dobson v. Commissioner of Internal Revenue, supra.* It would seem that this case furnishes an appropriate vehicle for further clarification of this recurrent and important question.

4. The question of whether a business concern is entitled to have adjudicated in a tax case, in lieu of declaratory relief, findings of fact made by the commissioner damaging to its assets and making uncertain its corporate and tax status in future years, is one of first instance. In any event the Tax Court made findings of primary facts favorable to the petitioner on all such issues presented, but it failed to make ultimate findings thereon. For the circuit court to have failed to make such ultimate findings, or to have required them to be made, is in conflict with *Kelleher, Exec., v. Comm.,* 94 F. (2d) 294 (C. C. A. 9th, 1938), holding that the finding of all ultimate facts by the Tax Court is a statutory duty.

5. It would also appear that with respect to the procedure referred to in the preceding paragraph that the circuit court has so far sanctioned a departure by the Tax Court from the accepted and usual course of judicial pro-

ceeding as to call for an exercise of this court's power of supervision.

Wherefore, your petitioner prays that a writ of certiorari issue under the seal of this court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding said court to certify and send to this court a full and complete transcript of the record and of the proceedings of said court, numbered 10959, and had in docket number 109993 of the Tax Court of the United States, to the end that this case may be reviewed and determined by this court as provided by the statutes of the United States; and that judgment herein of said circuit court and of said Tax Court be reversed and that petitioner have such further relief as to this court may seem proper.

Dated this 16th day of April, 1946.

WALTER H. MALONEY and
GEORGE ACRET,
Attorneys for Petitioner.

IN THE

Supreme Court of the United States

October Term, 1945.

No.....

BIRCH RANCH AND OIL COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief in Support of Petition for Writ of Certiorari.

The Opinion Below.

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit is reported in 152 F. (2d) 874. The opinion is also printed in full in the record. [R. 238.]

Jurisdiction.

The grounds and facts concerning jurisdiction are set forth in the foregoing petition.

Statement of the Case.

The facts are stated in the Summary Statement of the Matter Involved.

The specific conclusions, or ultimate findings, of the commissioner which petitioner sought to have redeter-

mined, and concerning which the Tax Court made no ultimate findings but made findings of primary facts favorable to petitioner [R. 83-100], are as follows:

> "Deduction of $119,400 as taxes 'For Bond Interest, Reclamation District No. 2035,' is disallowed since it is held that your return is made on the basis of cash receipts and disbursements and the said item was not paid in the taxable year and the information and evidence available indicate that it will never be paid. The bonds were held by Birch Securities Company and the capital stock of said corporation was wholly owned by Birch Holding Company, which corporation also owns your entire capital stock, and the form employed in creating the alleged liability is unreal and a sham. Furthermore, it is held that no bonds were ever issued by Reclamation District No. 2035 within the meaning of section 3480 of the Political Code of California and therefore there is no obligation against the district under which you are required to pay or accrue interest on bonds or taxes. (48.)" [R. 40.]

The Tax Court's findings of primary findings of fact negativing each of the aforesaid conclusions appear commencing at R. 83.

Petitioner expressly assigned as error in the circuit court the Tax Court's failure to make ultimate findings upon its findings of primary facts as follows:

> "1. The court erred in failing to expressly find that Reclamation District No. 2035 is a duly organized Reclamation District of the State of California;
>
> 2. The tax court erred in failing to expressly find that said bonds are valid reclamation district bonds constituting a lien or charge upon petitioner's lands;

3. The tax court erred in failing to expressly find that petitioner's entire system of accounting is upon an accrual basis;

* * * * * * * *

5. The tax court erred in failing to expressly find that said system of accounting truly reflects petitioner's income;

6. The tax court erred in failing to find that petitioner is a corporation organized in good faith for the purpose of procuring bank and other credit and for the purpose of engaging in business upon its own account, so as to entitle it to be treated as a corporate entity separate and apart from its shareholders;

7. The tax court erred in failing to find that the entire amount of $120,000.00, deducted by petitioner for each of the years 1937 and 1939, and under the provisions of sections 23 (c) (1) (E) of the Internal Revenue Code and of section 19.23c (3) of Regulations 103, *was a proper deduction as taxes* to meet accrued interest in said amount on said bonds;" (Emphasis added.) [R. 228; also see R. 220.]

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in Appendices A and B, attached.

Errors Relied Upon.

The United States Circuit Court of Appeals erred:

1. In holding that no clear-cut question of law is presented where the Tax Court found that every item of accounts receivable and payable were entered on petitioner's books of account as the same accrued, and where the

Tax Court concluded therefrom that petitioner's books of account are kept on a cash basis.

2. In failing to hold that payment to the county treasurer to meet accruing interest owed by a reclamation district on bonds of the district is a payment deductible on an income tax return as taxes.

3. In failing to require the Tax Court to make ultimate findings of fact, or to itself make such ultimate findings, concerning various material issues upon which the Tax Court made findings of primary facts favorable to petitioner.

Summary of Argument.

1. Section 43 of the Revenue Acts of 1936 and 1938 (Appendix A) permits a taxpayer as a matter of right to account for income tax upon an accrual basis. The Tax Court made primary findings of fact establishing that petitioner entered on its books of account every item of accounts receivable and payable as the same accrued. [R. 98.] It did not find that this system did not correctly reflect petitioner's net income. It nevertheless concluded that its ranch books are kept on a cash basis. The circuit court held this conclusion to be a question of fact behind which it cannot go, citing *Dobson v. Commissioner of Internal Revenue,* 320 U. S. 489, 88 L. Ed. 249, and *United States v. Anderson,* 269 U. S. 422, 443, 70 L. Ed. 347, 352, in support of its decision. It would seem that on the contrary this holding is in conflict with both decisions and has no "reasonable basis in the law." Also, it would seem to be in conflict with *Security F. M. Co. v. Comm., supra.*

2. The sum of $120,000 accruing annually as interest on $2,000,000 of bonds of the reclamation district is an obligation of the district and not of the land owner. [R. 217.] (Sec. 3480, California Political Code, Appendix A.) The Tax Court itself so held in *Little v. Comm.*, 21 B. T. A. 911. It is the only expense of the district. [R. 166.] Therefore, the total amount of tax of the district to meet such expense is the sum of $120,000, irrespective of the occurrence of any other event. Petitioner has the right to deduct this amount from its income, as taxes and not as interest. *Little v. Comm., supra.* It has a right to, and *it is obliged* to, accrue this amount on its books as taxes payable though no assessment for such amount has been made. *U. S. v. Anderson, supra.*

3. In assessing the deficiency, the commissioner declared unreal and a sham petitioner's corporate form, the validity and reality of the reclamation district and of the bonds, and left uncertain petitioner's tax liability and proper method of accounting in the future. From the evidence, and the Tax Court's findings of primary facts, it appears the commissioner's findings were carelessly made without any realization of their effect upon the market value and saleability of petitioner's land and the entire $2,000,000 bond issue. In view of the fact that declaratory relief is not available in tax matters (28 U. S. C. 400) petitioner seeks a rule as of first instance in furtherance of justice, that a taxpayer is entitled in a tax case to ultimate findings of fact upon all issues properly raised. In any event, where the Tax Court made findings of primary facts, as here, the taxpayer has a right to ultimate findings thereon. *Kelleher, Exec., v. Comm., supra.*

POINT I.

The Holding That Petitioner Kept Its Ranch Books on a Cash Basis Is an Ultimate Finding and the Circuit Court Erred in Failing to Hold That Whether Such Ultimate Finding Is Supported by the Tax Court's Findings of Primary Facts Is a Clear-cut Question of Law.

From the findings of the primary facts of the Tax Court it appears that petitioner included in its income tax returns the net income from the ranch, as well as all other income, and included as an accrued item as part of such net income the only accrued item which existed concerning the ranch, to wit, the said sum of $120,000 involved herein. [R. 97, 98.] It would therefore seem obvious that the filing by petitioner of Form 1040F, in addition, did not in any manner change or affect the amount of petitioner's net income or tax. It affirmatively so appears in the record. [R. 97, 133.] The Tax Court made no findings to the contrary. According to the commissioner's own regulations the filing of Form 1040F was in the instant case unnecessary and mere surplusage. (Regulation 103, Section 19.22(a)-7, Appendix A.)

As held in *Cole, Exec., v. Comm.*, 81 F. (2d) 485 (C. C. A. 9th), the ultimate fact is the ultimate conclusion which is justified by the primary facts. As quoted under "Summary Statement of Matters Involved" herein, the Tax Court made primary findings establishing in effect that all sales and purchases for the ranch are made in cash, that all crops are grown and sold during the same fiscal year, the inventory of stock is maintained at the same level, and that petitioner reported on an accrual basis the only accrued item which concerned the ranch, to-wit: the aforesaid item of $120,000. [R. 97, 98.]

It would seem too clear for argument that the ultimate findings or conclusion from such primary findings is whether petitioner keeps its books of account, and filed its income tax return, upon a cash or an accrual basis. It is a question of law whether the primary facts justify the finding of the ultimate facts. *Remco S. S. Co. v. Comm.*, 22 F. (2d) 988 (also C. C. A. 9th). From *U. S. v. Anderson, supra,* it appears that, in holding from such primary facts that the books are kept on a cash basis, the circuit court made a clear-cut mistake of law.

As stated in *Dobson v. Comm., supra:*

> "It is difficult to lay down rules as to what should or should not be reviewed in tax cases except in terms so general that their effectiveness in a particular case will depend largely upon the attitude with which the case is approached. However, all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court. *Its decision, of course, must have 'warrant in the record' and a reasonable basis in the law."* (Emphasis added.)

As stated in *Security F. M. Co. v. Comm., supra:*

> "The question is not whether the Board, within its discretion, made a determination of fact. Compare Dobson v. Commissioner of Internal Revenue, 320 U. S. 489, 64 S. Ct. 239. It is rather whether, as matter of law, the Board misconstrued the extent of the power conferred by the Revenue Act."

These are the clear-cut questions of law which the Circuit Court failed to decide.

POINT II.

The Circuit Court Erred in Failing to Hold That Payment by a Reclamation District Land Owner to the County Treasurer to Meet Accrued Interest Owed by the District on Its Bonds, Is a Payment Deductible on the Land Owner's Income Tax Return as Taxes.

The Tax Court made findings of primary facts establishing in effect that in exchange for the use of the property of the district the petitioner paid all of the operating expenses of the district. [R. 97.] The only expense of the district was therefore the sum of $120,000 interest accruing annually at 6% on $2,000,000 bonds.

The fact would seem to be immaterial that petitioner made it a practice of purchasing matured interest coupons from various holders of said bonds for cash and then turned the coupons into the county treasurer for cancellation. [R. 122.] The statute expressly provides that payments may be made to the county treasurer with such interest coupons in lieu of money. (Political Code, Sec. 3480. (Appendix B.)

From the provisions of said Section 3480, such expense of the district by law must be met by the assessment of a tax in such amount. (Appendix B.) The sum of $120,000 therefore accrued as an annual tax, irrespective of any assessment being made, or the occurrence of any other event. Further by said statute, said sum to cover said interest became and remained a lien against petitioner's lands until paid. (Said Sec. 3480, Appendix B.) In

such circumstances the petitioner not only had a right, but was obliged, to accrue this item upon its books of account, and in its tax return, as an accrued item. In *U. S. v. Anderson, supra,* it is so held:

> "* * * In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued."

Not only the aforesaid provisions of the statute result, as a matter of law, in the accrual of such item of $120,000 *as a tax,* but the Tax Court itself, under a similar statute, so holds. In the *Little* case, *supra,* the Tax Court stated:

> "The interest due on the bonds of the Emmett Irrigation District, a legal entity, was the obligation of the district and not an indebtedness of this petitioner. Cf. Claude Nichols Comstock, 15 B. T. A. 769.
>
> "* * * As pointed out above, the Commissioner has interpreted the law so as to allow the owners of land within an irrigation district to deduct assess-

ments for maintenance as expenses incurred in business. *Assessments for interest on bonds logically fall within the same class of expenditure, but may not be allowed as deductions as interest paid by the taxpayer, as hereinbefore decided.*

* * * * * * * *

"We are of the opinion that this petitioner is entitled to deduct the amount of $4,630.72 assessed for interest on irrigation district bonds *as taxes* paid within the meaning of section 214(a)(3) of the Revenue Act of 1921." (Emphasis added.)

The Circuit Court in its opinion misstated the aforesaid clear-cut question of law, and then ignored it.

Though the Tax Court made findings of primary facts herein establishing, as a matter of law, that petitioner is obligated to pay $120,000 annually to the district *as a tax* it did not make an ultimate finding thereon. [R. 83-100.] Yet the Ninth Circuit in *Kelleher, Exec., v. Comm., supra,* in reversing the Tax Court, held and stated as follows:

"The Board, in this case, found a great number of evidentiary facts, but not the ultimate facts necessary to a decision. We are now asked to find the ultimate facts, thus relieving the Board of its statutory duty. . . ."

It would seem that the Circuit Court did not decide in accordance with its own former decision.

POINT III.

The Circuit Court Erred in Not Making, or Requiring, to Be Made, Ultimate Findings Upon the Findings of Primary Facts Made by the Tax Court. In Addition, Petitioner Seeks a Rule of First Instance in Furtherance of Justice That in a Tax Matter Ultimate Findings Must Be Made Upon All Issues Properly Raised.

In its petition in the Tax Court petitioner prayed for redetermination of all of the commissioner's hereinbefore quoted conclusions and alleged *in extenso* all of the facts with relation thereto. [R. 13-34.] It expressly assigned each of such conclusions as error. [R. 5-12.] The Tax Court made findings of primary facts favorable to petitioner upon each of such assignments. [R. 83-100.] With reference to the status of petitioner as a separate corporate entity it found as follows:

> "Beginning in 1925, up to and including 1934, Birch and his wife for the Conaway Ranch formally paid over $120,000 per year for disbursement as interest on the bonds of Reclamation District No. 2035. Such portion of the amount so paid as was applicable to bonds owned by Birch and his wife was repaid to them, but under a claim that interest on such bonds was tax exempt, the amounts so received were not reported by them as taxable income. In each of the said years, Birch and his wife, on their income tax returns, claimed a deduction of $120,000 as interest paid. The propriety of these deductions was questioned by the Bureau of Internal Revenue for practically every year, but in each instance the deduction was ultimately allowed.
>
> On October 15, 1934, Birch and his wife organized Birch Ranch and Oil Company, the petitioner

herein, and transferred to it the Conaway Ranch, their interest in the Birch Oil Company, the partnership which succeeded the Menges Oil Company in 1911, and all other property belonging to them, except the bonds of Reclamation District No. 2035, certain corporate stock and other properties having a value of about $600,000. Birch had been having difficulties during the depression years in borrowing on his personal credit the moneys needed for the operation of the ranch, *and the petitioner was organized for the purpose of procuring needed bank credit.*" (Emphasis added.) [R. 93.]

From the foregoing it appears Mr. and Mrs. Birch were permitted and entitled to make the deduction even when they owned both the lands of the reclamation district and a large portion of its bonds. It would seem, under the aforesaid facts, difficult to conceive of a corporation entitled to greater consideration as a separate corporate entity. The corporation was obvziously not organized even for the legitimate purpose of tax avoidance.

The necessity for the petitioner's obtaining some adjudication upon the commissioner's aforesaid false conclusions, and the damaging character thereof to the market value of petitioner's lands and to the entire $2,000,000 bond issue, would seem obvious. Also, it would seem obvious that such conclusions made uncertain petitioner's system of accounting and tax liability in the future. Yet the Tax Court failed to make any finding of ultimate fact upon any of the aforesaid findings of primary facts and stated in its opinion as follows:

"In view of the conclusions reached and the reasons therefor, we find it unnecessary to rule on the petitioner's claim that the bonds of Reclamation Dis-

trict No. 2035 were and are valid and subsisting obligations constituting a lien or charge upon the property of the petitioner so as to entitle it to deduct so much of the amounts paid thereunder as is allocated to interest. Neither do we find it necessary to rule on the contention of the respondent that the owners of the bonds herein in question were in reality the owners of the land against which the bonds were issued, and that the bonds do not, therefore, represent real and actual obligations outstanding." [R. 106.]

Yet in *Kelleher, Exec., v. Comm., supra,* the circuit court held the making of ultimate findings a statutory duty. Irrespective of the application of such a rule it would seem that in furtherance of justice such important issues ought not be left hanging in the air and that a taxpayer, after having had the value of its property so unjustly and carelessly damaged, ought not be left entirely without means of judicial relief.

Conclusion.

From the foregoing it would appear that the errors herein of the courts below are of such general public concern as to justify the interposition of this court for each of the reasons stated in the petition.

Respectfully submitted,

WALTER H. MALONEY and
GEORGE ACRET,
Attorneys for Petitioners.

APPENDIX A.

REVENUE ACTS OF 1936 AND 1938.

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:" * * *

"(b) INTEREST.—All interest paid or accrued within the taxable year on indebtedness, except" * * *

"(c) TAXES GENERALLY.—Taxes paid or accrued within the taxable year except—" * * *

"(4) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges."

"Sec. 24. ITEMS NOT DEDUCTIBLE.

* * * * * * * * *

"(c) UNPAID EXPENSES AND INTEREST.—In computing net income no deduction shall be allowed in respect of expenses incurred under section 23 (a) or interest accrued under section 23 (b)—

"(1) If not paid within the taxable year or within two and one-half months after the close thereof; and" * * *

"Sec. 41. GENERAL RULE.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method em-

ployed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does not clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)"

"Sec. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

"The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

"Sec. 48. DEFINITIONS.

"When used in this title—" * * *

"(c) PAID, INCURRED, ACCRUED.—The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part."

REGULATION 103, SECTION 19.22(a)-7.

"Form 1040F should be filled in and attached to his income tax return by every farmer who either keeps no records or only records of cash receipts and disbursements; its use is optional with other farmers."

REGULATION 103, SECTION 19.23(c)-3.

"Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and if the assessments are so limited, the amounts paid thereunder are not deductible as taxes. The above statements are subject to the exception that in so far as assessments against local benefits are made for the purpose of maintenance of repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible."

APPENDIX B.

CALIFORNIA POLITICAL CODE, SEC. 3478.

"All reclamation districts now legally existing in this state, which were created by or formed under the provisions of any provisions of any statute of the state, shall henceforth be subject to the provisions of the Political Code of the state of California relating to reclamation districts the same as though such districts had been formed by or created under the provisions of said code relating to 'swamp and overflowed, salt marsh and tide lands'; provided, that this provision shall not affect any proceeding that shall have been already commenced for the levy or collection of assessments in such districts when this act takes effect, nor shall it affect any act done or performed in relation to the affairs of such districts prior to such last mentioned date, nor the indebtedness of such districts theretofore incurred, excepting as to the method of liquidating such indebtedness; and all the provisions of the Political Code for assessments and issuing bonds by reclamation districts are hereby made applicable to the districts mentioned in this section. (Enacted 1872; Amended by Stats. 1911.)"

* * * * * * * * *

"At least ninety days before any interest date of the bonds, including refunding bonds, the county treasurer of the main county shall estimate the amount of money necessary to pay interest and principal maturing on such interest date after crediting thereon the funds in the treasury applicable to the payment thereof, and the expenses of the county treasurer hereinafter provided and shall add thereto fifteen per cent of such aggregate sum to cover possible delinquencies. * * *"

* * * * * * * * *

"The lien of any unpaid assessment upon which bonds shall have been issued shall continue until all said bonds, and any refunding bonds which may be issued, shall have been paid in full except as hereinafter provided in reference to the use of bonds as payment of assessments, and if for any reason any part of such principal or interest of said bonds, or of refunding bonds shall remain unpaid after enforcement of said assessment as in this article provided, the board of supervisors of the main county shall order an additional or supplemental assessment to be made as provided in section 3459, sufficient to pay such unpaid principal and interest; which additional or supplemental assessment shall be enforced and collected in the same manner as the original assessment."

* * * * * * * * *

"The word installment as used in this section shall be construed as applying to interest as well as the principal as the case may be."

* * * * * * * * *

"Said installment may be paid either in cash or in bonds of said district, or their interest coupons, issued upon said assessment, then matured or to mature within ninety days from the date of the calling of such installment, taken at their face value, or part in cash and part in such bonds and/or coupons. Any bond or coupon so received in payment shall be by the treasurer forthwith canceled and filed in his office. If any part of such installment or any interest thereon shall remain unpaid at the expiration of thirty days from the date of said notice, it shall become delinquent and ten per cent of the unpaid amount of said installment shall be added thereto and collected by said treasurer."

Service of the within and receipt of a copy thereof is hereby admitted this..... day of April, A. D. 1946.

_____

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 1171

BIRCH RANCH AND OIL COMPANY, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 82–108) is unreported. The opinion of the Circuit Court of Appeals (R. 238–241) is reported at 152 F. 2d 874.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 9, 1946. (R. 241–242.) Petition for rehearing was denied February 13, 1946. (R. 242.) The petition for a writ of certiorari was filed on April 30, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner owned a ranch and was also interested in several other business enterprises. The Tax Court found that petitioner maintained a separate set of books for the ranch and kept them on the cash basis, although its books for its remaining activities may have been on the accrual basis. In connection with the ranch petitioner had undertaken to pay interest on the bonds of a reclamation district within which the ranch was located.

The question presented is whether petitioner may deduct $100,800 which accrued as interest on those bonds in 1937 and 1939, but which petitioner in fact did not pay.[1]

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations involved are set out in the Appendix, *infra,* pp. 20–23.

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[1] The Tax Court found it unnecessary to pass on the contention of the Commissioner that "in view of the closely controlled corporate arrangement there was in fact no real or actual obligation outstanding against the petitioner or its property to pay the interest claimed as deductions" and the court below did not ocnsider it. (R. 38, 40–41, 102, 106–107.) The contention of the petitioner (Pet. 6–7, Br. 19–21) that the Tax Court should have been compelled to make ultimate findings of fact which were in no way material to the issue which was decided is plainly without merit. *Kelleher* v. *Commissioner,* 94 F. 2d 294 (C. C. A. 9th), does not hold otherwise.

STATEMENT

Although the basic issue is a narrow one, the facts out of which this controversy arises are somewhat extended, and were found by the Tax Court as follows:

The petitioner, a Nevada corporation, with its principal office in Los Angeles, California, was organized by Mr. and Mrs. A. Otis Birch on October 15, 1934. They transferred to it the Conaway Ranch, their interest in the Birch Oil Company (a partnership which succeeded the Menges Oil Company in 1911) and all other property belonging to them, except the bonds of Reclamation District No. 2035, certain corporate stock and other properties having a value of about $600,000. Mr. Birch had been having difficulties during the depression years in borrowing on his personal credit the moneys needed for the operation of the ranch, and the petitioner was organized for the purpose of procuring needed bank credit. (R. 83, 84, 93.)

The partners in the Birch Oil Company were Mr. and Mrs. Birch, Mr. and Mrs. B. F. Conaway, and Mr. Birch's nieces, referred to herein as the Hopkins sisters. In 1914 this partnership purchased about 13,000 acres of overflow lands situated about five miles from Sacramento, in Yolo County, California, and in the Sacramento River Valley. The lands were purchased for farming and stock raising, and came to be known as the

Conaway Ranch. Additional acreage was thereafter purchased and by 1918 the ranch contained about 20,000 acres. All purchases had been made at $35 per acre. (R. 83, 84.)

At the time of the original purchase in 1914, the Sacramento and San Joaquin Drainage District, created under the laws of California, had started a flood control project which called for the acquisition of a by-pass across the Conaway Ranch, for the passage of excess flood-waters of the Sacramento River and its tributaries. The by-pass was then being surveyed, and it was expected that about one-half of the Conaway ranch would be taken for that purpose. The Reclamation Board of California informed Birch Oil Company that if the latter would construct a levee across its ranch property, adjacent to the by-pass, an assessment would be made against all the lands in the Sacramento and San Joaquin Drainage District to pay that company for flowage rights through the by-pass and for the construction of the levee. It expected to receive $25 an acre for the acreage used for the by-pass. Such acreage, according to law, could not be fully reclaimed and was suitable only for grazing. (R. 84–85.)

Desiring to reclaim and develop the lands comprising the Conaway Ranch, the Birch Oil Company, in 1918, filed a petition with the Board of Supervisors of Yolo County, California, for the creation of a reclamation district which would

include the Conaway Ranch and other land not owned by the Birch Oil Company or its members. In April, 1919, the establishment of Reclamation District No. 2035, comprising most of such land, was approved by the Board of Supervisors. (R. 85.)

Organization of the district was completed and the County Board of Supervisors appointed trustees for the district who, in June, 1919, employed an engineer and directed him to prepare plans for the reclamation and irrigation of lands in the district, with estimates of the cost of the necessary improvements. In a proceeding brought by the trustees to determine the legality of the district, the Superior Court of California for the County of Yolo, in June, 1920, entered its judgment that Reclamation District No. 2035 is "a duly and regularly organized and legal Reclamation District". In the same month, the trustees approved the plans submitted by the engineer and his estimate of $2,264,740 as the cost of the improvements. The plans submitted called for the construction of the main levee along the edge of the Yolo By-pass, as above described. After these plans were approved by the California Reclamation Board and the Board of Supervisors, commissioners were appointed to assess the value of the benefits to the lands in the district from the improvements contemplated and to apportion the cost of the improvements according to the benefits that would accrue to each tract of land. There-

after, and prior to July 2, 1924, the commissioners made such assessment and apportionment, the assessment was approved by the Board of Supervisors, and the list of assessment was filed on July 23, 1924, with the County Treasurer of Yolo County. (R. 85–86.)

The Birch Oil Company, under the direction of the district's engineer, built the improvements called for in the reclamation plan and financed all the costs, which were slightly in excess of $2,000,000. The work was substantially completed by 1925 and Birch had then acquired individually and at undisclosed costs seven of the eight parcels of land which, with the Conaway Ranch, comprised the land of the district. The parcel not so purchased consisted of 240 acres. (R. 86–87.)

In the meantime, the Hopkins sisters, being desirous of disposing of their interests in the Conaway Ranch, by agreements dated January 1, 1924, sold such interests to Mr. and Mrs. Birch for $787,000, an amount designed to pay them their proportionate part of the Birch Oil Company funds invested in the ranch. Under the agreements each of the sisters agreed to accept bonds of Reclamation District No. 2035 of $393,000 and cash in the sum of $500. Birch and his wife agreed to cause the district to issue bonds in an amount of at least $800,000, which were to constitute a prior lien on all of the property in the district. Birch and his wife were to have immediate and absolute posses-

sion and control of the properties acquired from the Hopkins sisters and were to be entitled to all rents and profits and were to assume all liabilities and burdens incident to the ownership thereof. The bonds not having been issued at the time of the agreements on January 1, 1924, Birch gave each of the sisters his promissory note in an amount equal to the amount of the bonds she was entitled to receive under the agreements. (R. 87–88.)

According to the minutes, the landowners, at an election held on August 28, 1924, voted to issue bonds to pay for the reclamation work which had been done, and on October 26, 1924, the trustees adopted resolutions providing for the issuance of bonds. (R. 88.)

On January 5, 1925, the trustees of the district adopted resolutions directing that the district pay Birch and Conaway $2,000,000 for moneys advanced in the construction of the improvements. On the same day Warrant No. 1 for $2,000,000, drawn on the Treasurer of Yolo County, was issued to Conaway and Birch but was not paid for want of funds. (R. 88–89.)

On January 7, 1925, the trustees of the district delivered to the County Treasurer bonds of the district totaling $2,264,740. The bonds bore interest at the rate of six percent per annum until paid and were in denominations of $1,000. The first $227,000 thereof were to mature on January 1, 1935, with a like amount maturing on January

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1, of each year following until January 1, 1944, when the bonds then remaining and amounting to $221,740, were to mature. Also on January 7, 1925, the County Treasurer gave notice that on January 23, 1925, he would sell Bonds Nos. 1 to 2,000, inclusive, of $2,000,000 par value, to the highest bidder. Birch, acting for himself, Mrs. Birch and the Conaways, was the highest bidder, his bid being $2,000,000 plus accrued interest. Being the highest bidder he became the purchaser of the bonds and gave in payment therefor Warrant No. 1 of the district, which had been received by him and Conaway in payment for the building of the improvements for the district. (R. 89.)

In a proceeding brought by the trustees of the district, the Superior Court of California for the County of Yolo, on March 2, 1925, entered its judgment "that said bonds are a valid legal obligation of said Reclamation District No. 2035." (R. 89–90.)

Upon receipt of such bonds Birch delivered to each of the Hopkins sisters $393,000 par value of such bonds, or a total of $786,000, pursuant to the agreements of January 1, 1924. Upon delivery of the bonds, and in return he received the notes covering the purchase price of their interests in the ranch. At the same time the Hopkins sisters made formal conveyance to Birch and his wife of all their interest in the Conaway Ranch. (R. 90.)

At or about the same time the Hopkins sisters granted to Birch and his wife the right to pur-

chase the bonds received by them as above set forth. According to these agreements, Birch and his wife agreed to purchase at face value the bonds in question, the purchases from each sister to be made in installments as set out in the agreement. (R. 90–91.)

In 1926 Birch entered into an agreement with the Conaways for the purchase of their interests in the ranch and in the bonds of Reclamation District No. 2035. The purchase price was paid in cash and in installments. (R. 92.)

Beginning with January 1, 1926, the first installment date under the agreements of January 10, 1925, the Hopkins sisters elected to sell the bonds to Birch and his wife pursuant to the terms of the agreements. Birch and his wife made the payments on the bond purchases as called for in the agreements until the early 1930's, when, due to the depression and a resulting lack of funds, they were unable to make the further payments on the dates prescribed, and extensions of time have thereafter been allowed. The bonds paid for in the face amount of $476,000 were delivered to Birch and his wife. The Hopkins sisters still hold the remaining $310,000 of the bonds. (R. 92.)

Beginning in 1925, up to and including 1934, Birch and his wife formally paid over, for the Conaway Ranch, $120,000 per year for disbursement as interest on the bonds of Reclamation District No. 2035. Such portion of the amount so paid as was applicable to bonds owned by Birch

and his wife was repaid to them, but, under a claim that interest on such bonds was tax exempt, the amounts so received were not reported by them as taxable income. In each of the years Birch and his wife, on their income tax returns, claimed a deduction of $120,000 as interest paid. The propriety of these deductions was questioned by the Bureau of Internal Revenue for practically every year, but in each instance the deduction was ultimately allowed. (R. 93.)

Birch and his wife organized a second Nevada corporation on October 15, 1934. This was a holding company known as Birch Securities Company. To that corporation they transferred $1,594,000 par value of the reclamation bonds, being all of the bonds of the district except the $310,000 still in the hands of the Hopkins sisters and those held by an insurance company and Lula M. Minter. In addition, they transferred to the Securities Company the corporate stocks referred to above. (R. 94.)

Birch and his wife also organized on October 15, 1934, a corporation known as the Birch Holding Company, and transferred to it the stock of the petitioner and that of Birch Securities Company. (R. 94.)

At the time of its organization or on some date thereafter, the petitioner guaranteed performance by Birch and his wife of their contracts of January 10, 1925, with the Hopkins sisters. (R. 95.)

After its organization and for each of the years 1935 and 1936, the petitioner continued the practice of Birch and his wife paying over $120,000 for disbursement as interest on the $2,000,000 of bonds of Reclamation District No. 2035. But, beginning with 1937, no amount has been paid in any year by the petitioner as interest on the bonds transferred by Birch and his wife to the Birch Securities Company, nor has it paid any amount as interest on the bonds held by the Great Republic Life Insurance Company. As to the bonds held by the latter, there was a dispute between that company and the petitioner over the rights in and to those bonds. They were ultimately acquired by the petitioner from the insurance company in 1940, for $65,000. For each of the fiscal years 1937 and 1939 the taxpayer did pay $600 to Lula M. Minter as interest on the bonds which had been acquired by her and also paid $18,600 to the Hopkins sisters in each of those years on their bonds. (R. 95.)

On its books for the fiscal years 1937 and 1939, the petitioner accrued $120,000, to represent interest on the entire $2,000,000 par value of the bonds of Reclamation District No. 2035. For the fiscal year 1937, it entered the $18,600 paid to the Hopkins sisters, as above stated, as a loan to Birch Securities Company and that company treated the sum as a loan from the taxpayer and charged a net of $17,382.75 as interest paid to the Hopkins sisters. It claimed a deduction on its

income tax return for that year in the latter amount. (R. 96.)

At no time has any amount been paid into Reclamation District No. 2035, or set aside by Birch and his wife or the petitioner for the purpose of paying off the bonds of the district, even though the bonds began to mature on January 1, 1935, at the rate of $227,000 per year. In November of 1934, steps were taken to refund the original bonds with refunding bonds to mature at the rate of $50,000 per annum, beginning January 1, 1945. At the time of the hearing herein, all of the original bonds had been deposited for exchange but no exchange had occurred. (R. 96–97.)

Since its organization the petitioner has operated the Conaway Ranch, devoting it to the growing of crops and the raising of sheep. The petitioner, as owner of the Conaway Ranch, has borne all of the costs and expenses of maintaining and operating the improvements of Reclamation District No. 2035 and treats such costs as a part of its expenses in operating the ranch, all in a manner which would be no different if there were no reclamation district, whether formal or actual. The district has no expense not taken care of by the petitioner. (R. 97.)

All crops grown on the ranch during a given fiscal year are sold in the same year in which grown. The herd of sheep is kept at an average of 3,500, with losses being replaced by younger

animals. All sales are made for cash, as are all purchases. The petitioner keeps a separate set of books with respect to the ranch operations. The ranch books are kept on a cash basis. For each of the taxable years involved in this proceeding the petitioner used Form 1040 F [2] in reporting income from the operations of the ranch, and reported the income or loss therefrom on a cash basis. (R. 97.)

The petitioner does not own any oil properties directly, but it does have a partnership interest in Birch Oil Company, which owns and operates oil wells. The petitioner keeps its books and files its returns on the basis of a fiscal year ending September 30, while the Birch Oil Company keeps its books on a calendar year basis. At the close of its calendar year, Birch Oil Company determines its net income for the year and the amount distributable to each partner. The petitioner, as soon as it is informed of the amount, enters that amount on its books as income as of the end of December. The amount thus entered is reported as income by the petitioner on its return for the fiscal year ending on September 30 following. (R. 97–98.)

In addition to the ranch and the interest in the Birch Oil Company, the petitioner owns a citrus grove and various rental properties, in-

[2] Form 1040 F is a form filed by farmers with their income tax return.

cluding two small farms. The income from and the expenses incident to those properties are entered on taxpayer's books as they accrue. (R. 98.)

The petitioner in its income tax returns for the fiscal years 1937 and 1939 claimed for each year a deduction of $120,000, representing the amount accrued on its books to cover interest on the bonds of Reclamation District No. 2035. In determining the deficiencies, the Commissioner allowed the deductions only to the extent of $600, being the amount paid to Lula M. Minter. (R. 98–99.)

The Tax Court held that the petitioner was entitled to deduct the $18,600 paid to the Hopkins sisters as interest in the taxable years but denied the deduction of the remaining $100,800 which had been accrued as interest on petitioner's books. (R. 101–109.)

The Circuit Court of Appeals affirmed the Tax Court's decision. (R. 238–242.)

ARGUMENT

There is no conflict of decisions and the court below correctly affirmed the Tax Court's decision determining that the sum of $100,800, whether regarded as taxes or interest, was not deductible in the taxable years 1937 and 1939 since that sum was not paid out and the petitioner's books covering the Conaway Ranch were kept on a cash basis during the taxable years.

Net income is required to be computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer", and deductions must be taken in the year in which the sums involved are paid or accrued "dependent upon the method of accounting upon the basis of which the net income is computed". Sections 41 and 43 of the Revenue Acts of 1936 and 1938, Appendix, *infra*. The test laid down by the statute for determining whether the taxpayer is on the cash or accrual basis of accounting is what his books show and this presents a question of fact. Consequently the Tax Court's finding on such point must be sustained if supported by any substantial evidence. *Dobson* v. *Commissioner* 320 U. S. 489, rehearing denied, 321 U. S. 231; *Aluminum Castings Co.* v. *Routzahn,* 282 U. S. 92; *United States* v. *Anderson,* 269 U. S. 422.

In determining the accounting basis here, the Tax Court found in substance: (1) that the petitioner was engaged in several kinds of business operations; (2) that the interest item here involved had no connection whatsoever with any of its business except the operation of the Conaway Ranch which is located in the Reclamation District and is the property against which the assessment was made for the irrigation project; (3) that the books for the Conaway Ranch were kept entirely separate from the books for the petitioner's other business operations; and (4)

that the books for the ranch were kept on a cash basis and the income from those operations was so reported. (R. 97, 98, 103–104.) Accordingly, the Tax Court reached the conclusion that any sums accrued as interest but left unpaid during the taxable years could not be deducted in those years.

The Tax Court's findings are amply supported by the evidence. Petitioner's president testified that all of the business of the Conaway Ranch was on a cash basis, that the ranch has maintained the improvements of the Reclamation District for the use of such improvements and that it has undertaken the obligation of paying the interest on the district's bonds each year. (R. 133, 163–166.) The testimony of petitioner's secretary also shows that petitioner has several distinct business operations, that the books of the Conaway Ranch are kept separately from its other books and that the income tax return for the ranch was made on a cash basis by the ranch manager from books which he kept at the ranch. (R. 167–177, 183–184.) He also testified that the interest item here was accrued, but that cannot, of course, be the decisive factor since the evidence shows that all other items concerning the ranch were entered on a cash basis. *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 360. A taxpayer must be consistent in making bookkeeping entries and may not treat receipts on a cash basis while it accrues

expenditures or vice versa. *Mass. Mutual Life Ins. Co.* v. *United States,* 288 U. S. 269, 273.

United States v. *Anderson, supra,* does not support the petitioner's contention that the issue whether books were kept on the cash or accrual basis presents "a clear-cut question of law." In the *Anderson* case the taxpayer contended that it had not kept its books on the accrual basis but this Court held that the taxpayer was precluded on that point by findings of the Court of Claims that it had. The case did not arise in the Tax Court and it establishes no principles with respect to judicial review of Tax Court decisions. On the merits the decision supports the Government's position since it holds that a taxpayer keeping its books and accounts on one basis may not deduct a single item on a different basis.

Petitioner's argument that there was no rational basis in the primary findings to support the Tax Court's ultimate finding or conclusion that the books were kept on the cash basis is predicated on an erroneous statement as to the primary findings of fact. The Tax Court did not find, as stated, that petitioner entered on its books of account every item of accounts receivable and payable as the same accrued, including the only accrued item which concerned the ranch. (R. 98.) What it did find was that the taxpayer owned certain other properties, and the income from and expenses incident to those properties were entered on the petitioner's books as they accrued. (R.

98.) The material finding here is that the petitioner kept a separate set of books with respect to the ranch and the ranch books were kept on a cash basis. (R. 97, 103.)

As previously pointed out, the evidence clearly supports these findings. Whenever different business operations of a taxpayer are separated into distinct units, as in this case, the particular item involved must be treated as required by the accounting method used for such unit. *Cecil* v. *Commissioner,* 100 F. 2d 896 (C. C. A. 4th); *Stern* v. *Commissioner,* 14 B. T. A. 838, 843. The petitioner cites no authority to the contrary. Moreover, in the *Dobson* case, *supra,* the Supreme Court pointed out that (pp. 501–502) "Whatever latitude exists in resolving questions *such as those of proper accounting* * * * exists in the Tax Court."

There is no issue here as to statutory interpretation. Consequently this case is unlike *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, on which petitioner relies. In that case the taxpayer, admittedly on an accrual basis, argued that a contested liability, even if not properly accruable in the year when the liability arose, should nevertheless be deducted on the ground that the statute authorized a departure from the general rules governing deductions when observance of the regular annual accounting period would distort income. Thus it was necessary there to consider the meaning of the statutory provision covering ex-

ceptions to the general rule and as this Court decided that the taxpayer's interpretation of the law could not be accepted, the deduction was denied. The issue here is clearly different.

CONCLUSION

The decision of the court below is correct and presents no conflict with other cases. The petition for a writ of certiorari should be denied.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.

SEWALL KEY,
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LOUISE FOSTER,
Special Assistants to the Attorney General.

MAY 1946.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this title.

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—

* * * * *

(4) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed

does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

The corresponding sections of the Revenue Act of 1938, c. 289, 52 Stat. 447, contain the same provisions as those above.

Revenue Act of 1937, c. 815, 50 Stat. 813:

SEC. 301. DISALLOWED DEDUCTIONS.

(a) Section 24 (a) of the Revenue Act of 1936 is amended to read as follows:

* * * * *

"(c) *Unpaid Expenses and Interest.*— In computing net income no deduction shall be allowed in respect of expenses incurred under section 23 (a) or interest accrued under section 23 (b)—

"(1) If not paid within the taxable year or within two and one half months after the close thereof; and

"(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

"(3) If, at the close of the taxable year of the taxpayer or at any time within two and one half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24 (b)."

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (c)–3. *Taxes for local benefits.*— So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property

subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The real property taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and if the assessments are so limited, the amounts paid thereunder are not deductible as taxes. The above statements are subject to the exception that in so far as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible. In such cases the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amounts so paid is deductible.

The corresponding provision of Treasury Regulations 101, promulgated under the Revenue Act of 1938, is the same as the above.

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